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Office of the Legislative Auditor

State of Montana

Report to the Legislature

February 1991

Financial-Compliance Audit

For the Two Fiscal Years Ended June 30, 1990

Department of Revenue

This report contains 12 recommendations for improvement of the department's operations including recommendations relating to:

- Systems development.
- Compliance with appropriation language.
- Clarification of laws related to motor vehicle fleets.
- Recording and updating accounts receivable.
- Compliance with state laws.

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The Single Audit Act of 1984 and OMB Circular A-128 require the auditor to issue certain financial, internal control, and compliance reports regarding the state's federal financial assistance programs, including all findings of noncompliance and questioned costs. This individual agency audit report is not intended to comply with the Single Audit Act of 1984 or OMB Circular A-128 and is therefore not intended for distribution to federal grantor agencies. The Office of the Legislative Auditor issues a statewide biennial Single Audit Report which complies with the reporting requirements listed above. The Single Audit Report for the two fiscal years ended June 30, 1989 has been issued. Copies of the Single Audit Report can be obtained by contacting:

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February 1991

The Legislative Audit Committee
of the Montana State Legislature:

This is our financial-compliance audit report on the Department of Revenue for the two fiscal years ending June 30, 1990. Included in this report are recommendations concerning systems development; compliance with appropriation language; clarification of laws relating to motor vehicle fleets; recording and updating accounts receivable; and compliance with state laws. The department's response is located at the end of the report.

We thank the director and his staff for their assistance and cooperation.

Respectfully submitted,

Scott A. Seacat
Legislative Auditor

Office of the Legislative Auditor

Financial-Compliance Audit
For the Two Fiscal Years Ended June 30, 1990

Department of Revenue

Members of the audit staff involved in this audit were Maryrose Beasley, Laurie Evans, Scott Hoversland, Jim Manning, Victoria Murphy, Paul J. O'Loughlin, Julie Quist, and Catherine L. Scarff.

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Department of Revenue	Denis Adams	Director
	Judy Rippingale	Deputy Director for Tax Policy
	Jack Ellery	Deputy Director for Operations
Division Administrators	Don Bentson	Centralized Services
	Brenda Haseman	Data Processing
	Jeff Miller	Income and Miscellaneous Tax
	Gary Blewett	Liquor
	Norris Nichols	Motor Fuels Tax
	Jerry Foster	Natural Resource & Corporation Tax
	Ken Morrison	Property Assessment

The listing below serves as a means of summarizing the recommendations contained in the report, the department's response thereto, and a reference to the supporting comments.

Recommendation #1

We recommend the department:

A. Perform a post-implementation review of the new liquor computer system to determine if the system is operating as intended. 9

Agency Response: Concur. See page 44.

B. Develop procedures to control systems development projects. 9

Agency Response: Concur. See page 44.

Recommendation #2

We recommend the department:

A. Submit operating plan amendments transferring appropriation authority to ensure appropriations are spent in compliance with state law. 11

Agency Response: Concur. See page 45.

B. Establish and implement a system to ensure transactions recorded on the state's accounting records are charged to the proper appropriation. 11

Agency Response: Concur. See page 45.

Recommendation #3

We recommend the department ensure its budget system monitors compliance with personal services limitations. 12

Agency Response: Concur. See page 45.

Recommendation #4

We recommend the department:

A. Obtain budget amendments to ensure appropriations are spent in compliance with state law. 14

Agency Response: Concur. See page 46.

B. Properly record expenditures for federal programs on the state's accounting records. 14

Agency Response: Concur. See page 46.

C. Request reimbursement for all allowable expenditures. 14

Agency Response: Concur. See page 46.

Recommendation #5 — We recommend the department seek legislation clarifying state laws pertaining to personal property taxes on interstate motor vehicle fleets. 16

Agency Response: Concur. See page 46.

Recommendation #6 — We recommend Inheritance Tax and Centralized Services personnel work together to accurately report inheritance tax accounts receivable on the state's accounting system. 18

Agency Response: Concur. See page 46.

Recommendation #7 — We recommend the department update accounts receivable for tax liability settlements. 18

Agency Response: Concur. See page 47.

Recommendation #8 — We recommend the department seek legislation clarifying state law regarding the distribution of beer and wine taxes based upon updated census figures.. 20

Agency Response: Concur. See page 47.

Recommendation #9 — We recommend the department seek legislation to amend state law requiring common carriers to report to the department all shipments of cigarettes and beer within the state. 21

Agency Response: Concur. See page 47.

Recommendation #10 — We recommend the department establish procedures to ensure revenue distributions are made in compliance with state law. 22

Agency Response: Concur. See page 48.

Recommendation #11 — We recommend the department comply with state law and claim indirect costs to the maximum extent possible. 23

Agency Response: Concur. See page 48.

Recommendation #12 — We recommend the department require railroad carriers use the report form prescribed by the department. 24

Agency Response: Concur. See page 48.

Introduction

We performed a financial-compliance audit of the Department of Revenue for the two fiscal years ended June 30, 1990. The objectives of our audit were to:

1. Determine the department's compliance with applicable state and federal laws and regulations.
2. Make recommendations for improvement in the management and internal controls of the department.
3. Determine if the department's financial schedules present fairly the results of its operations for the two fiscal years ended June 30, 1990.
4. Determine the implementation status of prior audit recommendations.

In accordance with section 5-13-307, MCA, we analyzed and disclosed the costs, if significant, of implementing recommendations contained in this report.

Department Organization and Functions

The Department of Revenue was created by the Executive Reorganization Act of 1971. The department's primary function is the administration of state tax laws. The department had approximately 677 full-time equivalent employees in fiscal year 1989-90. The department currently consists of the Director's Office and seven divisions. The duties and functions of the office and divisions are described as follows:

Director's Office is responsible for advising the Governor on matters affecting the department, recommending changes to Montana tax laws and policies, providing policy direction to all divisions within the department, and coordinating the department's biennial budget. The Office of Legal Affairs, Office of Investigation, Office of Research and Information, and the Office of Personnel and Training are part of the Director's Office.

Income and Miscellaneous Tax Division is responsible for administering the Montana individual income tax laws, including employer withholding. The division is also responsible for

administering miscellaneous taxes and licenses not administered by other divisions including tobacco, accommodations, inheritance, and estate taxes.

Liquor Division is responsible for administering the state alcoholic beverage codes, including taxation, licensure, and regulation. It also supervises the operation of the liquor enterprise activities consisting of a liquor warehouse, state liquor stores, and agency liquor stores.

Motor Fuels Tax Division is responsible for licensing and administering taxes on gasoline, diesel fuel, gasohol, and aviation fuel.

Natural Resource and Corporation Tax Division is responsible for administering corporation taxes and taxes applied to natural resources. Included as part of the natural resources bureau is the processing and auditing of taxes such as coal, oil and natural gas severance, net proceeds tax on oil and gas, and resource indemnity trust tax.

Property Assessment Division is responsible for valuing all taxable property in the state. The division is charged with assuring uniformity among the various counties and with determining the value of taxable property which crosses county lines.

Centralized Services Division is responsible for providing support services for the department including central mail processing, cashiering, accounting, payroll, and internal management review.

Data Processing Division is responsible for providing data processing, systems development, and maintenance services for the department.

Prior Audit Recommendations

Prior Audit Recommendations

The financial-compliance audit report of the department for the two fiscal years ended June 30, 1988 contained nine recommendations. We determined the department implemented five prior recommendations; partially implemented three; and did not implement one recommendation. The recommendation not implemented relates to cigarette and beer taxes and is discussed on page 20. The three partially implemented recommendations discussed in this report concern: inheritance tax accounts receivable (page 16); federal indirect cost recoveries (page 23) and railroad liquor excise tax (page 23). Our report also discusses recurring problems which are similar to items discussed in our 1984 EDP audit and our 1986 financial-compliance audit of the department. The recurring problems involve post-implementation review procedures for computer applications (page 4), compliance with appropriation language (page 9), and recording receivables when a final settlement is reached (page 18).

Findings and Recommendations

Automated Liquor System

At June 30, 1990, the department's Liquor Division supervised operations of the state liquor warehouse, 30 state stores, and 89 agency stores. During the audit period, the department began implementing a new automated liquor inventory management and accounting system. Prior to implementation, the department's System Development Bureau performed a preliminary analysis of developing a new mainframe application. Based on this preliminary review, department management decided the most cost effective alternative was to purchase a minicomputer and a vendor software package. Management of the Liquor and the Centralized Services Divisions use information generated from the new system to monitor and make decisions concerning liquor operations, and to record activity on the state's accounting system. The following are examples of reports used by the department:

1. Store sales and inventory,
2. Cost of sales,
3. Overages and shortages,
4. Shipments to stores, and
5. Purchases from vendors.

Prior to implementation of the new liquor system in April 1989, the department tested the data converted from the previous mainframe application to ensure data was not lost in the conversion process. However, the department did not perform appropriate testing procedures to ensure proper processing of information and accuracy of reports generated by the new system. Because the Liquor Division did not adequately test the system prior to using it, the division did not understand the limitations of the new system. As discussed in the following paragraphs, system limitations include inaccurate reports and not producing all reports necessary to manage the state liquor operations and properly distribute liquor revenue.

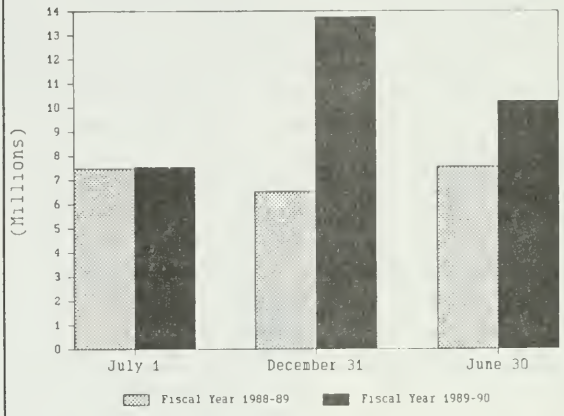
When the Liquor Division began using the new system, the department had not completed the programming for all reports. Division personnel stated they believed they had the essential reports needed to fill store orders and perform warehouse

purchasing functions. They believed these reports were sufficient to operate the liquor system while providing time to complete programming of the additional reports. However, our audit determined the division did not have all the essential reports needed to operate and manage the state liquor operations. For example, the system did not produce the cost of sales report. As discussed later, this resulted in the department incorrectly distributing liquor revenue.

Because of problems the department encountered with the new automated liquor system, excessive inventory occurred. Liquor Division personnel stated the liquor system "went down" a number of times during July 1989 due to power outages. Due to the problems, the warehouse could not compile orders for the regular shipments to the stores. This resulted in low inventories at the stores. The liquor stores tried to compensate for the low inventories by ordering more stock. The warehouse was left with low levels of inventory once the store orders were filled. The Liquor Division, in turn, placed large orders with vendors in anticipation of more orders from the stores. As a result, both the warehouse and stores had excess inventory levels during fiscal year 1989-90. The inventory value increased from $7.5 million at June 30, 1989 to $13.7 million at December 31, 1989. From December 31, 1989 to June 30, 1990, the inventory value decreased to $10.2 million. The following graph illustrates inventory levels at three points of time during fiscal years 1988-89 and 1989-90.

Figure 1

Liquor Inventory Balances



Source: Compiled by the Legislative Auditor's Office from the Statewide Budgeting and Accounting System.

In addition, we noted errors in recording unit price amounts, transfers between stores, and shipments from the warehouse during our testing of the monthly store sales and inventory reports (MSSI). For example, four items we tested on one store's MSSI for December 1989 were sale items for the month but the retail price was used on the report. Liquor Division personnel stated similar instances occurred on reports from July through November 1989. The incorrect prices were a result of Liquor Division personnel either restoring incorrect price data to the system after the computer "went down" or inputting new monthly price data onto the computer before completing the previous month's reports. Inaccurate recording of prices, transfers, and shipments on the system also affect each store's computed sales amount. The department compares the computed sales amount to the actual sales reported by the store to determine any overage or shortage. The overage or shortage amounts are a management tool which serves as a "flag" in detecting theft, loss, or excessive breakage. The department has

not been able to rely on this important management information since April 1989.

The cost of sales report was one of the reports which was not initially produced. Centralized Services Division needed information from this report to distribute gross liquor receipts between sales and taxes on the state's accounting records. Since the report was not available by fiscal year-end, Centralized Services personnel estimated distributions of liquor receipts to sales and taxes for the last three months of fiscal year 1988-89. In addition, they failed to distribute $118,900 of fiscal year 1988-89 liquor receipts.

The cost of sales report is also affected by inaccurate reporting of prices, transfers, and shipments on the system. In analyzing the distribution of fiscal year 1989-90 liquor receipts, we noted the amount of liquor receipts deposited from stores exceeded the amount distributed to sales and taxes by approximately $747,000. Centralized Services Division should have transferred at least $95,000 of this amount to the General Fund as tax revenue.

Prior to implementing the new system, the department performed routine audits of state and agency liquor stores. Currently, the department only audits agency stores which close or change agents. Centralized Services Division personnel stated they have not performed regular financial audits of agency stores since the new system was implemented because of inaccurate reports. The department limits its audits to store closures and agent changes because it must manually go through each of the MSSI reports from April 1989 to the date of the audit and perform a complete inventory count in order to determine the correct over or short amount. Department personnel stated this is a time-consuming process. For other agency stores, the department performs a review to ensure the agent follows proper procedures as outlined in the agent store manual; but, shortages are not calculated and collected from the agents under this type of review.

The problems noted above indicate the department did not follow adequate systems development procedures in implementing the new automated liquor system. As the department encountered a problem, it used a crisis management approach to correct each problem. Adequate systems development, including systems testing and development of a user's procedure manual, would have prevented many of the problems. Based on the concerns noted with the system, the department should perform a post-implementation review. A similar problem was noted in our 1984 Electronic Data Processing (EDP) audit of the department's data processing activities. During our EDP audit, we noted department procedures did not provide for a post-implementation review of the application development process. A post-implementation review should be performed to obtain feedback on where the application development process was successful, and where the process needs improvement.

In performing a post-implementation review, the department should analyze:

1. Whether development and implementation progressed according to plan.

2. Whether original cost/benefit projections were accurate, and whether the application is cost beneficial as implemented.

3. Whether application security is adequate.

4. Whether the application meets user needs, or if additional revisions should be made to the application.

5. Whether application documentation is complete and adequate.

We recognize this will entail the use of additional resources; however, the cost of this review will be offset by eliminating the staff time and effort incurred in dealing with the problems of the current system. We believe this is an important step in ensuring the system is operating reliably as planned.

Recommendation #1

We recommend the department:

A. Perform a post-implementation review of the new liquor computer system to determine if the system is operating as intended.

B. Develop procedures to control systems development projects.

Compliance with Appropriation Laws

As part of our audit of the department, we tested compliance with appropriation laws, policies, and procedures. This testing included ensuring compliance with restrictive language contained in the general appropriation bills and reviewing appropriation balances at the end of each fiscal year to ensure transfers of expenditures between appropriations were proper. The department must ensure expenditure transfers comply with the appropriation laws. Our audit for the two fiscal years ended June 30, 1986 noted a similar concern with expenditure transfers. The following report sections discuss concerns noted during our current appropriations testing.

Transferring Appropriation Authority versus Expenditures

At fiscal year-end 1988-89, the department transferred $42,380 of personal service expenditures from three General Fund appropriations dealing with Property Assessment to another appropriation (Railroad Appraisal). The transfer document stated the transfer was to eliminate negative balances in the three appropriations. House Bill 2, Laws of 1987, appropriated funds in fiscal year 1988-89 to the Property Assessment Division "to deal with legal issues arising under federal non-discriminatory taxation acts. . . This appropriation may be used only for attorney fees, expert witnesses, and extraordinary expenses associated solely with resolving disputes related to such legal issues." Section 17-8-103(2), MCA, states "a condition or limitation contained in an appropriation act shall govern the

administration and expenditure of the appropriation . . ." The document transferring the expenditures did not have support attached to justify the transaction. Property Assessment personnel subsequently provided documentation for $23,734 of expenditures meeting the restrictions of House Bill 2. The remaining portion of the transfer resulted in the department overcharging the Railroad Appraisal appropriation by $18,646. The department should develop procedures to charge expenditures to the proper appropriation as they are incurred in order to provide a more efficient and accurate accounting of the expenditures.

We noted a similar instance during fiscal year 1989-90. The department transferred $40,000 of personal service expenditures out of the appraisers/assessor staff appropriation and recorded the expenditures in the elected and deputy assessors appropriation. The document description noted the reason for the transaction was to resolve a negative balance for the appraisers and assessor staff appropriation.

As noted above, section 17-8-103(2), MCA, states that a condition or limitation in an appropriation act governs the expenditure of the appropriation. The narrative to the appropriations act describes the elected and deputy assessors appropriation as containing the personal services budget for Montana's elected county assessors and deputy assessors. By transferring expenditures which relate to appraisers and assessor staff to the elected and deputy assessors appropriation, the department violates section 17-8-103(2), MCA.

Centralized Services Division personnel stated they were under the impression the department could move expenditures between the Property Assessment Division appropriations, if necessary, to correct for negative balances. Based on our discussions with the Office of Budget and Program Planning staff, the department should have processed an operating plan amendment transferring the expenditure authority between the appropriations involved.

Recommendation #2

We recommend the department:

A. Submit operating plan amendments transferring appropriation authority to ensure appropriations are spent in compliance with state law.

B. Establish and implement a system to ensure transactions recorded on the state's accounting records are charged to the proper appropriation.

Personal Service Limitations

House Bill 100, Laws of 1989, section 7, states, "Expenditures by a state agency must be made in substantial compliance with an operating budget approved by an approving authority . . . Substantial compliance means that no category in the approved operating budget may be exceeded by more than 5 percent, provided that no funds appropriated for personal services or indicated in legislative intent as having been appropriated for personal services may be expended under any other category . . ." In fiscal year 1989-90, the department's approved operating budget for the income tax program included an authorized budget for operating expenses of $1,176,207. The department's fiscal year 1989-90 operating expenditures were $1,206,523, thereby exceeding its operating expense budget by $30,046. The operating expense category did not exceed the operating budget amount by more than 5 percent. However, as shown below, the department expended $28,398 of personal service appropriation authority ($30,046 less $1,648 of remaining equipment authority) for the operating expense category.

Category	Operating Budget Amount	Fiscal 1989-90 Expenditures	Balance
Personal Service	$2,334,941	$2,190,691	$144,250
Operating Expense	1,176,207	1,206,253*	(30,046)
Equipment	10,164	8,516	1,648
Total	$3,512,312	$3,405,460	$115,852

* Amount excludes $1,895 of operating expenses related to a statutory appropriation and not House Bill 100.

Centralized Services Division personnel interpret the personal service limitation as relating to the collective expenditures of all programs rather than on a program-by-program basis. House Bill 100 states "Each operating budget must include expenditures for each agency program . . ."; therefore, the personal service limitation applies on a program basis. To properly account for the expenditures in excess of the authorized operating budget, the department should have submitted an operating plan amendment transferring nonpersonal service budget authority from another program to the income tax program. A budget program transfer could be obtained from another program since the department had not exceeded its 5 percent program transfer limitation.

Recommendation #3

We recommend the department ensure its budget system monitors compliance with personal services limitations.

Medicaid and Welfare Fraud Investigations

The department performs Medicaid and Welfare fraud investigations under contract with the Department of Social and Rehabilitation Services (SRS). The department bills SRS quarterly for the work performed for the benefit of the Medicaid and Welfare fraud programs (CFDA #s 13.775 and 13.780). The department's initial contract for fiscal year 1988-89 was $121,883 for Welfare fraud and $26,800 for Medicaid

fraud. In April 1989, the department received an amended contract amount because the federal reimbursement rate increased for Welfare fraud, retroactive to October 1988.

During the audit, we noted the department did not establish or amend its Welfare fraud appropriation authority for the contract amount. The department established the appropriation authority at $82,810 and subsequently amended it to $115,810. However, the final contract amount for Welfare fraud was $140,129. In order to spend within its appropriation authority as recorded on the state's accounting system, the department transferred $10,625 during fiscal year 1988-89 and $6,523 during fiscal year 1989-90 of fiscal year 1988-89 Welfare fraud expenditures to the Medicaid fraud appropriation authority. As a result, the state's accounting records do not accurately reflect the costs of the Welfare and Medicaid fraud programs. If the department had submitted a budget amendment increasing the Welfare fraud appropriation authority for the full contract amount, it could have properly charged the expenditures.

In addition, the billings sent to SRS for fiscal year 1988-89 do not agree with the amount reported on the state's accounting records. Federal regulations require costs be directly related to the specific grant and the primary accounting records should accurately reflect the costs associated with each federal program. The expenditures the department transferred to the Medicaid fraud program were not directly related to that grant and therefore the charges are not allowable. Department personnel indicated they believe it is appropriate to transfer expenditures between the two federal programs because both programs operate under the same contract with SRS.

Furthermore, since the department did not obtain budget amendments to record the appropriation authority for the full contract amount, the department did not request reimbursement from SRS for $4,545 of the Welfare fraud expenditures. As a result, it used $4,545 from the state General Fund to pay Welfare fraud expenditures which were the responsibility of the federal government during fiscal year 1988-89. A similar problem was noted in fiscal year 1989-90 which caused the

department to use $690 from the state General Fund to operate the Welfare fraud program. Section 17-2-108, MCA, states, "The department shall apply expenditures against non-General Fund money whenever possible before using the General Fund appropriations."

During the audit, we notified the department of our concerns relating to the charging of expenditures to the wrong federal program. The department acted on our concerns and processed budget authority change requests and corrected the expenditures between Welfare and Medicaid fraud programs for both fiscal years. The department also billed SRS for the additional $4,545 of fiscal year 1988-89 and $690 of fiscal year 1989-90 expenditures relating to the Welfare fraud program.

Recommendation #4

We recommend the department:

A. Obtain budget amendments to ensure appropriations are spent in compliance with state law.

B. Properly record expenditures for federal programs on the state's accounting records.

C. Request relmbursement for all allowable expenditures.

Clarify Laws Relating to Taxing of Motor Vehicle Fleets

Section 15-24-104(2), MCA, states that the department or its designated agent, is responsible for the collection of personal property taxes on interstate motor vehicle fleets. The department calculates an average statewide mill levy as required by section 15-24-103, MCA. During our audit period, the calculated average statewide mill levy included the statewide 6 mill levy for the university system and the 45 mills (28 mills for elementary districts plus 17 mills for the high school districts) for state equalization aid. Currently the Department of Highways, Gross Vehicle Weight (GVW) Division, uses the statewide

mill levy provided by the department and collects the taxes on interstate motor vehicle fleets. All money collected by GVW is remitted to the counties for deposit in the counties' general fund as mandated by section 15-24-105, MCA.

Depositing all property tax collections from motor vehicle fleets in the county general fund fails to address the legal requirements of the statewide property tax levies for the university system and the school equalization aid account. Section 15-10-106, MCA, levies a 6 mill tax upon the taxable value of all real and personal property. The law requires the funds collected by the 6 mill levy be deposited to the state Special Revenue Fund for the university system. During our audit period sections 20-9-331, MCA, stated, "The county commissioners of each county shall levy an annual basic tax of 28 mills on the dollar of the taxable value of all taxable property within the county, except for vehicles subject to taxation under section 61-3-504(2), for the purposes of local and state foundation program support. The revenue collected from this levy must be apportioned to the support of the foundation programs of the elementary school districts in the county and to the state special revenue fund, state equalization aid account, . . ." Section 20-9-333, MCA, contains the exact same language except the millage is 17 for the support of foundation programs of high school districts. Since the tax on interstate motor vehicle fleets is not specifically exempted from the university millage and school equalization statutes, these statutes require these taxes to be levied on the property and deposited in the university system and equalization aid accounts.

We notified the department of our concerns. Department officials responded "The Department of Highways is responsible for interstate licensing fees (61-3-713 and 61-3-722)." However, section 15-24-104(2), MCA, states the department or its designated agent is responsible for the collection of personal property taxes on interstate motor vehicle fleets.

The GVW Division, Department of Highways, collected a total of $54,462,086 over the last 12 years and remitted it to the counties for deposit in the counties' general fund. None of

these tax collections have been deposited to the university millage or equalization aid accounts. For the audit period, we determined the amount associated to the university millage is $92,965 and $79,602 for fiscal years 1988-89 and 1989-90, respectively. In addition, $697,232 and $597,019 for fiscal years 1988-89 and 1989-90, respectively, is associated to the equalization aid account. The department should have either levied an additional 6 mills and 45 mills on this property for the university and school equalization aid accounts or withheld from the amounts remitted to the counties the amounts associated with university and school equalization accounts. The department should seek legislation clarifying state laws pertaining to personal property taxes on interstate motor vehicle fleets.

Recommendation #5

We recommend the department seek legislation clarifying state laws pertaining to personal property taxes on interstate motor vehicle fleets.

Improve Accounts Receivable Recording

Correct Reporting of Inheritance Tax Accounts Receivable Balances

The department has not accrued interest on inheritance tax accounts receivable in accordance with state policy. State policy (MOM 2-1100.3) requires the recognition of revenue in the accounting period in which it becomes susceptible to accrual. Because the department does not accrue the interest, accounts receivable in the General Fund is understated by $306,613 and $379,214 at June 30, 1989 and 1990, respectively.

According to Centralized Services personnel, they believed Inheritance Tax personnel included interest in the accounts receivable amount. Inheritance Tax personnel indicated they

did not know they should include the interest in the accounts receivable amount.

In a related matter, we noted six instances where the June 30, 1990 accounts receivable balance was not reduced for inheritance tax payments received during May 1990. State Policy (Management Memo 2-90-3) requires the liquidation of receivables as cash is collected and requires management to make adjustments, as necessary, to ensure the year-end accounting records and reports are properly stated. As a result of the department not adjusting the June 30, 1990 accounts receivable balance for May 1990 receipts, accounts receivable were overstated by $343,760 in the General Fund at June 30, 1990.

The county treasurers collect inheritance tax and submit the moneys collected to the department by the 20th day of the month following the month the inheritance tax is collected. According to Inheritance Tax personnel, they received some of the May 1990 reports from the county treasurer's offices after June 30, 1990. Because Inheritance Tax personnel provide Centralized Services the receivables information as close to June 30 as possible, they did not adjust the accounts receivable amount for May receipts reported to them after June 30. However, Inheritance Tax personnel could provide adjustments to Centralized Services after June 30 but prior to the fiscal year-end closing.

In the last three audit reports, we noted problems related to inheritance tax accounts receivable. The department has repeatedly concurred with the recommendations yet has failed to address the concerns we have noted. The department indicated that since inheritance tax accounts receivable only make up a small portion of the department's total accounts receivable, it does not have sufficient resources available to correct the problems. The issues addressed above primarily deal with the need for better communication between Centralized Services personnel and Inheritance Tax personnel during fiscal year-end. We believe the department could have prevented these errors with a minimum amount of effort.

Recommendation #6

We recommend Inheritance Tax and Centralized Services personnel work together to accurately report inheritance tax accounts receivable on the state's accounting system.

Establishing Accounts Receivable When Final Settlement is Reached

In June 1989, the department reached a $213,989 settlement with a corporate taxpayer for Resource Indemnity Trust and Coal Severance taxes. The department did not record the receivable on the state's accounting system even though the taxpayer did not pay the taxes until October 1989. Consequently, the department understated accounts receivable in the General, Special Revenue, and Debt Service Funds by $23,662, $111,603, and $78,724, respectively, at June 30, 1989.

Natural Resource and Corporation Tax Division personnel stated they did not record the receivable on the state's accounting system because payments are generally made upon settlement or within approximately one week after settlement. However, state policy requires receivables be recorded when the amount is known and collection is reasonably certain. A similar issue was reported during our audit of the department for the two fiscal years ended June 30, 1986.

Recommendation #7

We recommend the department update accounts receivable for tax liability settlements.

did not know they should include the interest in the accounts receivable amount.

In a related matter, we noted six instances where the June 30, 1990 accounts receivable balance was not reduced for inheritance tax payments received during May 1990. State Policy (Management Memo 2-90-3) requires the liquidation of receivables as cash is collected and requires management to make adjustments, as necessary, to ensure the year-end accounting records and reports are properly stated. As a result of the department not adjusting the June 30, 1990 accounts receivable balance for May 1990 receipts, accounts receivable were overstated by $343,760 in the General Fund at June 30, 1990.

The county treasurers collect inheritance tax and submit the moneys collected to the department by the 20th day of the month following the month the inheritance tax is collected. According to Inheritance Tax personnel, they received some of the May 1990 reports from the county treasurer's offices after June 30, 1990. Because Inheritance Tax personnel provide Centralized Services the receivables information as close to June 30 as possible, they did not adjust the accounts receivable amount for May receipts reported to them after June 30. However, Inheritance Tax personnel could provide adjustments to Centralized Services after June 30 but prior to the fiscal year-end closing.

In the last three audit reports, we noted problems related to inheritance tax accounts receivable. The department has repeatedly concurred with the recommendations yet has failed to address the concerns we have noted. The department indicated that since inheritance tax accounts receivable only make up a small portion of the department's total accounts receivable, it does not have sufficient resources available to correct the problems. The issues addressed above primarily deal with the need for better communication between Centralized Services personnel and Inheritance Tax personnel during fiscal year-end. We believe the department could have prevented these errors with a minimum amount of effort.

Recommendation #6

We recommend Inheritance Tax and Centralized Services personnel work together to accurately report inheritance tax accounts receivable on the state's accounting system.

Establishing Accounts Receivable When Final Settlement is Reached

In June 1989, the department reached a $213,989 settlement with a corporate taxpayer for Resource Indemnity Trust and Coal Severance taxes. The department did not record the receivable on the state's accounting system even though the taxpayer did not pay the taxes until October 1989. Consequently, the department understated accounts receivable in the General, Special Revenue, and Debt Service Funds by $23,662, $111,603, and $78,724, respectively, at June 30, 1989.

Natural Resource and Corporation Tax Division personnel stated they did not record the receivable on the state's accounting system because payments are generally made upon settlement or within approximately one week after settlement. However, state policy requires receivables be recorded when the amount is known and collection is reasonably certain. A similar issue was reported during our audit of the department for the two fiscal years ended June 30, 1986.

Recommendation #7

We recommend the department update accounts receivable for tax liability settlements.

State Compliance

We reviewed state laws and regulations pertaining to the department. The following report sections discuss compliance issues we noted during the audit.

Beer and Wine Tax Distribution Based on Outdated Population Census Information

The department is responsible for the collection of taxes on the sale of beer and wine within the state. Section 16-1-410, MCA, requires the department to distribute beer taxes collected to incorporated cities and towns in the direct proportion the population of each city and town bears to the total population of all incorporated cities and towns, as shown in the latest official federal census. In addition, section 16-1-411, MCA, requires the department to distribute a portion of wine taxes collected to counties, cities, and towns based on population.

The department distributed the taxes it collected using the official 1980 census. However, the Census and Economic Information Center, Department of Commerce, made several population adjustments to census information after its original publication. It published a revised official census to reflect these changes. For example, one city annexed an area with 10,139 people in 1985. According to Census and Economic Information Center personnel, the above adjustments were official adjustments and became part of the official federal census.

The department did not update its census information to reflect any official adjustments. Department officials stated the law refers to the decennial census because at the time sections 16-1-410 and 16-1-411, MCA, were enacted, official adjustments to the census were not routinely made. However, we believe the legislature intended the distribution be made based upon the best available information, which at the time the laws were enacted, was the decennial census. Now that more frequent adjustments are made to the official census figures, these adjustments provide the best available information upon which to base the tax distributions. For example, the quota for issuance of all beverage liquor licenses is based upon the most recent population estimates of incorporated cities as described in section 16-4-502, MCA.

From 1980 to 1985, the department underdistributed tax revenues to four cities and overdistributed all other cities. In addition, because of the previous errors and the impact of the annexation in 1985, the department underdistributed tax revenues to two cities and overdistributed tax revenues to all other cities since 1985. For example, in fiscal years 1988-89 and 1989-90, the department underdistributed tax revenues of $22,377 and $22,531, respectively to the two cities.

To ensure incorporated cities and towns receive the correct amount of beer and wine tax, the department should seek legislation clarifying sections 16-1-410 and 16-1-411, MCA, to distribute beer and wine taxes based upon all official adjustments to the decennial census figures.

Recommendation #8

We recommend the department seek legislation clarifying state law regarding the distribution of beer and wine taxes based upon updated census figures.

Cigarette and Beer Shipments

The department is responsible for the collection of taxes on the sale of cigarettes and beer in the state. Section 16-11-111, MCA, requires cigarette manufacturers, wholesalers, and retailers to report to the department sales or shipments of cigarettes, and to remit to the department cigarette taxes through the purchase of cigarette tax decals. Sections 16-1-406 and 16-3-231, MCA, require brewers and beer wholesalers to report to the department sales and shipments of beer and to remit to the department applicable beer taxes.

The department does not obtain shipping reports from common carriers transporting cigarettes or beer to points within the state as required by sections 16-3-235 and 16-11-104, MCA. Department officials stated that the common carrier reporting

requirements are not enforced since the shipping reports received from cigarette manufacturers, wholesalers, and retailers and from brewers and beer wholesalers are considered adequate. However, the department could cross-reference common carrier reports with the reports it currently receives to help ensure the accuracy and completeness of the tax returns.

Our prior audit report discussed this issue. Department officials indicated they did not introduce legislation to repeal the law related to cigarette common carrier reports because the reports would be important if legislation is passed to allow out of state stamping of cigarettes. The department would then use the common carrier reports to ensure it collects taxes on all cigarettes sold in the state. Department officials stated they overlooked introducing legislation to repeal the beer common carrier reports but indicated they would support legislation introduced in the future. If the department believes the reports will be needed in the future, it should seek legislation to permit, rather than require, reports of cigarette and beer shipments. This allows the department the flexibility to obtain common carrier reports when needed.

Recommendation #9

We recommend the department seek legislation to amend state law requiring common carriers to report to the department all shipments of cigarettes and beer within the state.

Distributions and Transfers

As discussed in the following paragraphs, the department did not distribute all revenue collected in compliance with state law. Due to the errors, fiscal year 1989-90 revenue in the General Fund distributions are understated by $1,255,887 and understated in the Special Revenue Fund by $147,638.

The department collects fees from licenses issued for the sale of distilled spirits, beer or wine. It deposits these fees in the Liquor Enterprise Fund. The department subsequently transfers the fees to the state General Fund in accordance with section 16-2-108, MCA. At June 30, 1990, the department collected $369,743 more in license fees than it transferred to the General Fund. As a result, transfers out in the Enterprise Fund and transfers in to the General Fund are both understated by $369,743. Department personnel indicated they were not sure why they did not transfer the entire amount of license fees to the General Fund. However, they transferred the $369,743 to the General Fund after we notified them of the error.

In a related matter, the department did not distribute all of the permanent coal and resource indemnity investment earnings in the Nonexpendable Trust Funds to the General and Special Revenue Funds in compliance with state law. As a result, transfers out are understated in the Nonexpendable Trust Fund by $1,033,782 and transfers in are understated by $886,144 in the General Fund and $147,638 in the Special Revenue Fund for fiscal year 1989-90. Department officials indicated that most of the current year underdistribution related to activity input by Board of Investments during the fiscal year-end cutoff period. Department officials were not aware of this activity until after the close of the fiscal year. They also acknowledged they should have distributed the prior year revenues. The department should contact the Board of Investments to determine if all investment revenue has been recorded. If not, the department should obtain an estimate of investment earnings and distribute the revenue during the fiscal year-end closing process.

Recommendation #10

We recommend the department establish procedures to ensure revenue distributions are made in compliance with state law.

Federal Indirect Cost Recovery

Federal regulations allow state agencies to request reimbursement for all indirect costs necessary for the administration of federal programs. Section 17-3-111, MCA, requires state agencies to recover indirect costs to the fullest extent possible. Recovery of indirect costs reduces the amount of state money required to support federal programs. The department has an approved indirect cost rate and a system to request reimbursement. However, the department did not recover indirect costs of $795 and $215 for fiscal years 1988-89 and 1989-90, respectively, for the federal Medicaid fraud program. Department personnel said they previously claimed indirect costs on Medicaid fraud when the program was much larger and operated as its own bureau within the department. With the dissolution of the bureau and a changeover in accountants responsible for preparing the federal billings, claiming indirect costs for Medicaid fraud was overlooked. We noted a problem involving two different federal programs in our prior report.

Recommendation #11

We recommend the department comply with state law and claim indirect costs to the maximum extent possible.

Railroad Liquor Excise Tax

Sections 16-1-402 and 403, MCA, require every airline and railroad operating in the state to pay excise taxes and the state markup on liquor purchased outside the state for consumption within the state. The department collected $15,185 and $27,626 in fiscal years 1988-89 and 1989-90, respectively, from these sources. The department is responsible for prescribing reporting forms for the carriers to use to ensure amounts collected are based on current excise tax and markup rates according to the calculation method required by state law. During the audit, we noted a passenger railroad carrier is not reporting its excise tax calculation on a form prescribed by the department. As a result, the department cannot ensure it is collecting the proper tax

amount from the carrier since the information provided by the carrier is incomplete.

We discussed this problem with department personnel during our interim work. Based on subsequent discussions between department personnel and the railroad, they determined the carrier calculates the tax due based upon liquor sales revenue in Montana rather than on the number of units sold in the state. This results in overpayments to the state. Department personnel stated the railroad carrier is requesting a refund of approximately $23,500 for overpayments of liquor taxes from January 1986 to September 1990.

This same issue was noted in our prior audit report. In that audit we noted the department should revise and update the prescribed form. We also noted the railroad carrier was using its own form. In response to our prior recommendation, the department revised the reporting form. However, the department did not require the railroad to use the proper form. We could find no documentation authorizing the railroad to use its own form. If the department had fully implemented our prior recommendation, the overpayment may have been detected sooner.

Recommendation #12

We recommend the department require railroad carriers use the report form prescribed by the department.

Clarification of State Laws

During the audit, we noted two instances where there is a conflict in references made in state law concerning the distribution of corporate license tax revenues and the tax rate on interstate motor vehicle fleets. First, section 15-31-702(a), MCA, states that 20 percent of corporation license taxes collected from banks or savings and loan associations must be distributed according to section 15-1-501(2), MCA. However, section 15-1-501(2), MCA, relates to the distribution of individual income tax revenue. Section 15-1-501(3), MCA, relates to the distribution of corporate license tax revenues. Previously, income and corporate taxes were distributed in the same percentages. However, during the 1987 legislative session, section 15-1-702, MCA, was not changed and section 15-1-501(3), MCA, was added to amend the distribution requirements for corporate license taxes.

Second, section 15-6-138(4), MCA, states class eight property is taxed at 9 percent of its market value. Class eight property includes trucks having a rated capacity of more than one ton, including those prorated under section 15-24-102, MCA. However, section 15-24-102, MCA, states the taxable value is 16 percent of the assessed value. The tax rate on class eight property was reduced from 16 percent to 11 percent in the 1987 legislative session and reduced to 9 percent during the June 1989 special legislative session. It appears section 15-24-102, MCA, was not amended to incorporate changes made to section 15-6-138, MCA.

In both instances discussed above, the department followed the intent of the law. It distributed the 20 percent of corporate licence taxes collected from banks and savings and loans according to the corporate distribution percentages and are assessing motor vehicle fleets at the 9 percent rate. We discussed the conflicts outlined above with the Code Commissioner. He included the change to section 15-31-702, MCA, in the Code Commissioner bill for the 1991 legislative session. The Code Commissioner referred the issue of motor vehicle fleets, mentioned in sections 15-6-138 and 15-24-102, MCA, to the

Revenue Oversight Committee. We, therefore, disclose these issues for informational purposes only and make no recommendation.

Independent Auditor's Report & Agency Financial Schedules

Summary of Independent Auditor's Report

Summary of Independent Auditor's Report

The auditor's opinion issued on the financial schedules contained in this report is intended to convey to the reader the degree of reliance which can be placed on the amounts presented. The reader may rely on the fairness of the amounts on the schedules presented on pages 30 through 40 when analyzing the financial activity of the Department of Revenue.

STATE OF MONTANA

Office of the Legislative Auditor

STATE CAPITOL
HELENA, MONTANA 59620
406/444-3122

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LEGAL COUNSEL:
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DEPUTY LEGISLATIVE AUDITORS:
MARY BRYSON
Operations and EDP Audit
JAMES GILLETT
Financial-Compliance Audit
JIM PELLEGRINI
Performance Audit

INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the financial schedules of the Department of Revenue for each of the two years ending June 30, 1989 and 1990, as shown on pages 30 through 40. These financial schedules are the responsibility of department's management. Our responsibility is to express an opinion on these financial schedules based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial schedules are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial schedules. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial schedule presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 1 to the financial schedules, the department's financial schedules are prepared in accordance with state accounting policy. Accordingly, the accompanying financial schedules are not intended to present the financial position and results of operations in conformity with generally accepted accounting principles.

In our opinion, the financial schedules referred to above present fairly, in all material respects, the results of operations and changes in fund balances of the Department of Revenue for the two years ending June 30, 1989 and 1990, in conformity with the basis of accounting described in Note 1.

Respectfully submitted,

James Gillett

James Gillett, CPA
Deputy Legislative Auditor

October 12, 1990

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DEPARTMENT OF REVENUE
SCHEDULE OF CHANGES IN FUND BALANCES
FOR THE TWO FISCAL YEARS ENDED JUNE 30, 1990

	General Fund	Special Revenue Funds	Debt Service Funds	Capital Project Funds	Enterprise Funds	Expendable Trust Funds	Nonexpendable Trust Funds
FUND BALANCE: July 1, 1988	$ 0	$ 3,824,218	$ 4,184,297	$ 60,173	$ 6,854,899	$13,877,073	$388,724,774
ADDITIONS:							
Fiscal Year 1988-89							
Budgeted Revenue & Transfers In	$ 287,632,547	$267,717,915	$ 71,761,294	$2,233,815	$43,490,753	$ 728,856	$ 51,865,640
Nonbudgeted Revenue & Transfers In	510,663	(78,164)	23,643	16,585	160,997		20,989,135
Prior Year Revenue Adjustments					7,604		
Direct Entries to Fund Balance							15,652,570[1]
Fiscal Year 1989-90							
Budgeted Revenue & Transfers In	311,819,082	285,157,706	79,867,583	2,965,295	44,105,751		62,972,833
Nonbudgeted Revenue & Transfers In	(1,354,731)[3]	(1,170,130)[3]	(151,585)[3]	63,194	1,011,287		25,391,367
Prior Year Revenue Adjustments	5,265		10				
Prior Year Transfers In Adjustments	29,695	18,520					
Total Additions	598,642,521	551,645,847	151,500,945	5,278,889	88,776,392	728,856	176,871,545
REDUCTIONS:							
Fiscal Year 1988-89							
Budgeted Expenditures & Transfers Out	17,407,111	10,821,689			43,597,126		45,647,801
Nonbudgeted Expenditures & Transfers Out	316,948		21,524,579		(1,052,431)[4]		
Prior Year Expenditure Adjustments	119,396	21,042			65,040		
Direct Entries To Fund Balance	1,046,640[1]	311,095				14,605,929[1]	
Support To State Of Montana	269,253,115						
Cash Transfers Out[2]		252,283,367	49,572,981	2,219,327			1,199,032
Nonbudgeted Prior Year Transfer Out Adjustments			(89,620)				
Nonbudgeted Prior Year Expenditure Adjustments					8,535		
Prior Year Revenue Adjustments							1,544
Fiscal Year 1989-90							
Budgeted Expenditures & Transfers Out	22,051,355	9,977,483			46,712,914		48,440,476
Nonbudgeted Expenditures & Transfers Out	190,619		25,552,674		(2,633,597)[4]		
Prior Year Expenditure Adjustments	17,519	38,851			22,820		
Support to State of Montana	288,239,818						
Cash Transfers Out		275,856,818	54,783,560	3,056,488	8,189		6,183,340
Prior Year Revenue Adjustments		519					94,612
Direct Entries to Fund Balance		630,713					
Prior Year Transfers Out Adjustments					48,218		
Nonbudgeted Prior Year Expenditure Adjustments					901,536		
Total Reductions	598,642,521	549,941,577	151,344,174	5,275,815	87,678,350	14,605,929	101,566,805
FUND BALANCE: June 30, 1990	$ 0	$ 5,528,488	$ 4,341,068	$ 63,247	$ 7,952,941	$ 0	$464,029,514

[1] See note #7.

[2] See note #6.

[3] See note #13.

[4] See note #2.

This schedule is prepared from the Statewide Budgeting and Accounting System. Additional information is provided in the notes to the financial schedules on pages 35 through 40.

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DEPARTMENT OF REVENUE
SCHEDULE OF BUDGETED REVENUE & TRANSFERS IN - ESTIMATE & ACTUAL
FOR THE FISCAL YEAR ENDED JUNE 30, 1990

	Licenses and Permits	Taxes	Charges For Services	Fines & Forfeits	Sale of Documents, Merchandise & Property	Other Financing Sources	Grants, Contracts, Donations & Abandonments	Federal	Investment Earnings	Total
GENERAL FUND										
Estimated Revenue	$ 288,100	$230,582,200	$ 5,600	$ 50,000	$ 1,600	$47,056,000				$277,983,500
Actual Revenue	288,537[3]	262,003,729	5,038	38,397	791	49,482,590				311,819,082
Collections Over (Under) Estimate	$ 437	$ 31,421,529	$ (562)	$(11,603)	$ (809)	$ 2,426,590				$ 33,835,582
SPECIAL REVENUE FUND										
Estimated Revenue	$ 34,200	$250,594,402	$1,655,295	$ 48,000		$12,540,685	$ 108,480	$266,337		$265,247,399
Actual Revenue	14,900	270,652,628	1,404,880	29,074		12,695,115	118,958	242,151[2]		285,157,706
Collections Over (Under) Estimate	$ (19,300)	$ 20,058,226	$ (250,415)	$(18,926)		$ 154,430	$ 10,478	$(24,186)		$ 19,910,307
DEBT SERVICE FUNDS										
Estimated Revenue		$ 67,567,000								$ 67,567,000
Actual Revenue		79,867,583								79,867,583
Collections Over (Under) Estimate		$ 12,300,583								$ 12,300,583
CAPITAL PROJECTS FUNDS										
Estimated Revenue		$ 2,290,000								$ 2,290,000
Actual Revenue		2,965,295								2,965,295
Collections Over (Under) Estimate		$ 675,295								$ 675,295
ENTERPRISE FUNDS										
Estimated Revenue	$1,522,000	$ 9,998,000			$33,733,000					$ 45,253,000
Actual Revenue	1,619,092[3]	8,843,422			33,643,237					44,105,751
Collections Over (Under) Estimate	$ 97,092	$ (1,154,578)			$ (89,763)					$ (1,147,249)
NONEXPENDABLE TRUST FUNDS										
Estimated Revenue		$ 10,887,000				$ 6,448,000	$1,050,000		$56,157,006	$ 74,542,006
Actual Revenue		12,479,370				0	924,593		49,568,870	62,972,833
Collections Over (Under) Estimate		$ 1,592,370				$(6,448,000)[1]	$ (125,407)		$(6,588,136)	$(11,569,173)

[1] See note #9.

[2] See note #12.

[3] See note #11.

This schedule is prepared from the Statewide Budgeting and Accounting System. Additional information is provided in the notes to the financial schedules on pages 35 through 40.

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DEPARTMENT OF REVENUE
SCHEDULE OF BUDGETED REVENUE AND TRANSFERS IN - ESTIMATE & ACTUAL
FOR THE FISCAL YEAR ENDED JUNE 30, 1989

	Licenses and Permits	Taxes	Charges For Services	Fines & Forfeits	Sale of Documents, Merchandise & Property	Other Financing Sources	Federal	Grants, Contracts, Donations & Abandonments	Investment Earnings	Total
GENERAL FUND										
Estimated Revenue	$1,774,500[2]	$222,102,600	$ 11,100	$49,000	$ 1,600	$42,602,000	$ 320,000[1]			$266,860,800
Actual Revenue	1,734,344	240,072,586	5,289	52,767	566	45,334,476	432,519			287,632,547
Collections Over (Under) Estimate	$ (40,156)	$ 17,969,986	$ (5,811)	$ 3,767	$ (1,034)	$ 2,732,476	$ 112,519			$ 20,771,747
SPECIAL REVENUE FUND										
Estimated Revenue	$ 20,700	$237,381,385	$1,333,348			$11,974,000	$1,448,299	$ 103,000		$252,260,732
Actual Revenue	22,117	252,819,736	1,301,825			12,062,179	1,394,197[1]	117,861		267,717,915
Collections Over (Under) Estimate	$ 1,417	$ 15,438,351	$ (31,523)			$ 88,179	$ (54,102)	$ 14,861		$ 15,457,183
DEBT SERVICE FUNDS										
Estimated Revenue		$ 67,968,000								$ 67,968,000
Actual Revenue		71,761,294								71,761,294
Collections Over (Under) Estimate		$ 3,793,294								$ 3,793,294
CAPITAL PROJECTS FUNDS										
Estimated Revenue		$ 2,140,000								$ 2,140,000
Actual Revenue		2,233,815								2,233,815
Collections Over (Under) Estimate		$ 93,815								$ 93,815
ENTERPRISE FUNDS										
Estimated Revenue		$ 8,185,000			$32,401,000					$ 40,586,000
Actual Revenue		8,863,697			34,627,056					43,490,753
Collections Over (Under) Estimate		$ 678,697			$ 2,226,056					$ 2,904,753
EXPENDABLE TRUST FUNDS										
Estimated Revenue						$ 696,000				$ 696,000
Actual Revenue						728,856				728,856
Collections Over (Under) Estimate						$ 32,856				$ 32,856
NONEXPENDABLE TRUST FUNDS										
Estimated Revenue		$ 4,385,000						$ 350,000	$43,498,006	$ 48,233,006
Actual Revenue		4,771,580						1,299,924	45,794,136	51,865,640
Collections Over (Under) Estimate		$ 386,580						$ 949,924	$ 2,296,130	$ 3,632,634

[1] See note #12.

[2] See note #11.

This schedule is prepared from the Statewide Budgeting and Accounting System. Additional information is provided in the notes to the financial schedules on pages 35 through 40.

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DEPARTMENT OF REVENUE
SCHEDULE OF BUDGETED PROGRAM EXPENDITURES AND TRANSFERS OUT
BY OBJECT AND FUND - BUDGET AND ACTUAL
FOR THE FISCAL YEAR ENDED JUNE 30, 1990

	Director's Office	Centralized Services	Data Processing	Liquor	Income Tax	Corporation Tax	Property Valuation	Motor Fuel Tax	Total
PERSONAL SERVICES									
Salaries	$ 771,061	$ 519,007	$ 917,000	$ 1,810,285	$1,783,081	$ 691,127	$ 7,059,754	$ 371,629	$ 13,922,944
Hourly Wages			181	305,770	949		1,244		308,144
Other Compensation				27,278			100		27,378
Employee Benefits	146,603	120,275	202,134	589,731	406,661	151,484	1,649,970	90,885	3,357,743
Total	917,664	639,282	1,119,315	2,733,064	2,190,691	842,611	8,711,068	462,514	17,616,209
OPERATING EXPENSES									
Other Services	160,335	59,602	49,942	1,460,902	779,755	123,596	518,587	73,136	3,225,855
Supplies & Materials	52,480	20,850	16,568	80,745	57,147	20,249	267,793	10,878	526,710
Communications	48,045	13,685	10,101	114,985	251,110	30,182	335,966	32,436	836,510
Travel	22,029	456	1,056	19,228	22,884	119,217	191,536	5,550	381,956
Rent	31,635	20,249	25,182	592,050	64,532	23,663	87,844	12,248	857,403
Utilities				104,913			598		105,511
Repair & Maintenance	24,627	8,057	22,391	47,924	16,187	4,253	175,496	4,007	302,942
Other Expenses	7,447	1,264	3,524	7,837	16,532	16,109	40,674	2,055	95,442
Goods Purchased For Resale				27,117,488					27,117,488
Total	346,598	124,163	128,764	29,546,072	1,208,147	337,269	1,618,494	140,310	33,449,817
EQUIPMENT AND INTANGIBLE ASSETS									
Equipment	26,279	4,680	2,786	15,898	8,516	795	104,693	7,438	171,085
Intangible Assets			4,995						4,995
Total	26,279	4,680	7,781	15,898	8,516	795	104,693	7,438	176,080
LOCAL ASSISTANCE									
From State Sources	3,106	2,323,849				6,505,043	4,774,506[1]		13,606,504
Total	3,106	2,323,849				6,505,043	4,774,506		13,606,504
BENEFITS & CLAIMS									
From State Sources	3,618								3,618
Total	3,618								3,618
TRANSFERS									
Accounting Entity Transfers		48,440,476		13,602,688		130,953			62,174,117
Total		48,440,476		13,602,688		130,953			62,174,117
DEBT SERVICE									
Installment Purchases							155,883		155,883
Total							155,883		155,883
TOTAL PROGRAM EXPENDITURES	$1,297,265	$51,532,450	$1,255,860	$45,897,722	$3,407,354	$ 7,816,671	$15,364,644	$ 610,262	$127,182,228
GENERAL FUND									
Budgeted	$ 881,857	$ 809,822	$ 889,082		$3,357,144	$ 1,326,810	$15,898,912		$ 23,163,627
Actual	738,810	768,125	801,124		3,254,773	1,123,879	15,364,644		22,051,355
Unspent Budget Authority	$ 143,047	$ 41,697	$ 87,958		$ 102,371	$ 202,931	$ 534,268		$ 1,112,272
SPECIAL REVENUE FUNDS									
Budgeted	$ 277,011	$ 2,421,570			$ 169,168	$ 7,344,016		$ 679,129	$ 10,890,894
Actual	197,999	2,323,849			152,581	6,692,792		610,262	9,977,483
Unspent Budget Authority	$ 79,012	$ 97,721			$ 16,587	$ 651,224		$ 68,867	$ 913,411
ENTERPRISE FUNDS									
Budgeted	$ 360,456		$ 454,736	$47,677,782					$ 48,492,974
Actual	360,456		454,736	45,897,722					46,712,914
Unspent Budget Authority	$ 0		$ 0	$ 1,780,060					$ 1,780,060
NONEXPENDABLE TRUST FUNDS									
Budgeted		$49,750,000							$ 49,750,000
Actual		48,440,476							48,440,476
Unspent Budget Authority		$ 1,309,524							$ 1,309,524

[1] See note #10.

This schedule is prepared from the Statewide Budgeting and Accounting System. Additional information is provided in the notes to the financial schedules on pages 35 through 40.

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DEPARTMENT OF REVENUE
SCHEDULE OF BUDGETED PROGRAM EXPENDITURES AND TRANSFERS OUT
BY OBJECT AND FUND - BUDGET AND ACTUAL
FOR THE FISCAL YEAR ENDED JUNE 30, 1989

	Director's Office	Centralized Services	Data Processing	Investigation and Enforcement	Liquor	Income Tax	Corporation Tax	Property Valuation	Motor Fuel Tax	Total
PERSONAL SERVICES										
Salaries	$ 431,077	$ 571,520	$1,066,970	$1,355,349	$ 1,815,396	$ 1,835,207	$ 780,049	$ 6,382,060	$ 348,721	$ 14,586,349
Hourly Wages					376,606	5,265		7,186		389,057
Other Compensation					23,063					23,063
Employee Benefits	80,760	125,934	236,331	301,877	627,874	412,586	165,353	1,531,975	82,709	3,565,399
Total	511,837	697,454	1,303,301	1,657,226	2,842,939	2,253,058	945,402	7,921,221	431,430	18,563,868
OPERATING EXPENSES										
Contracted Services	137,819	43,463	100,168	181,388	1,359,682	574,690	112,382	1,009,251	57,188	3,576,031
Supplies & Materials	21,025	24,931	15,172	62,381	78,372	94,190	22,753	270,023	7,558	596,405
Communications	12,706	18,766	11,826	131,778	121,373	254,839	32,965	248,899	37,674	870,826
Travel	6,126	135	405	35,004	17,557	39,348	117,209	189,937	1,604	407,325
Rent	10,975	19,334	25,711	82,670	658,969	61,097	22,555	85,821		967,132
Utilities					120,974			518		121,492
Repair & Maintenance	2,461	6,721	20,821	24,179	46,833	18,301	3,374	80,783	3,713	207,186
Other Expenses	4,535	687	2,108	9,138	12,250	10,829	5,843	41,729	1,749	88,868
Goods Purchased For Resale					24,910,598					24,910,598
Total	195,647	114,037	176,211	526,538	27,326,608	1,053,294	317,081	1,926,961	109,486	31,745,863
EQUIPMENT AND INTANGIBLE ASSETS										
Equipment	13,527	23,350	25,726	112,540	188,128	174,548	17,519	392,656	20,000	967,994
Total	13,527	23,350	25,726	112,540	188,128	174,548	17,519	392,656	20,000	967,994
LOCAL ASSISTANCE										
From State Sources		2,356,862		4,309			4,287,435			6,648,606
From Federal Sources				27,633						27,633
Total		2,356,862		31,942			4,287,435			6,676,239
BENEFITS & CLAIMS										
From State Sources	333									333
Total	333									333
TRANSFERS										
Accounting Entity Transfers		47,012,390			12,469,149		4,571			59,486,110
Total		47,012,390			12,469,149		4,571			59,486,110
DEBT SERVICE										
Installment Purchases								33,320		33,320
Total								33,320		33,320
TOTAL PROGRAM EXPENDITURES	$ 721,344	$ 50,204,093	$1,505,238	$2,328,246	$42,826,824	$ 3,480,900	$ 5,572,008	$10,274,158	$ 560,916	$117,473,727
GENERAL FUND										
Budgeted	$ 575,150	$ 840,134	$1,043,503	$ 575,449		$ 3,233,828	$ 1,225,619	$10,127,089		$ 17,620,772
Actual	561,114	828,241	1,007,749	546,785		3,226,260	1,122,981	10,113,981		17,407,111
Unspent Budget Authority	$ 14,036	$ 11,893	$ 35,754	$ 28,664		$ 7,568	$ 102,638	$ 13,108		$ 213,661
SPECIAL REVENUE FUND										
Budgeted	$ 99,845	$ 13,347,876	$ 75,109	$1,648,559		$ 269,935	$ 4,579,176	$ 160,177	$ 611,798	$ 20,792,475
Actual	80,698	3,728,051	75,109	1,513,071		254,640	4,449,027	160,177	560,916	10,821,689
Unspent Budget Authority	$ 19,147	$ 9,619,825	$ 0	$ 135,488		$ 15,295	$ 130,149	$ 0	$ 50,882	$ 9,970,786
ENTERPRISE FUNDS										
Budgeted	$ 79,532		$ 422,380	$ 268,390	$45,996,345					$ 46,766,647
Actual	79,532		422,380	268,390	42,826,824					43,597,126
Unspent Budget Authority	$ 0		$ 0	$ 0	$ 3,169,521					$ 3,169,521
NONEXPENDABLE TRUST FUNDS										
Budgeted		$ 47,276,000								$ 47,276,000
Actual		45,647,801								45,647,801
Unspent Budget Authority		$ 1,628,199								$ 1,628,199

This schedule is prepared from the Statewide Budgeting and Accounting System. Additional information is provided in the notes to the financial schedules on pages 35 through 40.

Notes to the Financial Schedules

For the Two Fiscal Years Ended June 30, 1990

1. Summary of Significant Accounting Policies

Basis of Accounting

The Department of Revenue uses the modified accrual basis of accounting, as defined by generally accepted accounting principles, for its Governmental and Expendable Trust Funds. In applying the modified accrual basis, the department records:

Revenues when it receives cash or when receipts are measurable and available to pay current period liabilities.

Expenditures for valid obligations when the department incurs the related liability and it is measurable.

The following additional items are considered valid obligations or expenditures under state accounting policy:

- The entire budgeted service contract even though the department received the services in a subsequent fiscal year.
- Goods ordered with a purchase order before fiscal year-end, but not received as of fiscal year-end.
- Equipment ordered with a purchase order before fiscal year-end.

State accounting policy also requires the department to record the cost of employees' annual leave and sick leave when used or paid.

The Department of Revenue uses accrual basis accounting for its Proprietary and Nonexpendable Trust Funds. Under the accrual basis, the department records revenues in the accounting period earned if measurable; they record expenses in the period incurred, if measurable.

Notes to Financial Schedules

Basis of Presentation

The financial schedules are prepared from the Statewide Budgeting and Accounting System without adjustment. Accounts are organized in funds according to state law. The department uses the following funds:

Governmental Funds

General Fund - to account for all financial resources except those required to be accounted for in another fund.

Special Revenue Fund - to account for proceeds of specific revenue sources legally restricted to expenditures for specific purposes. Major uses of this fund by the department include the deposit of money for Public School Equalization, Highways Special Revenue, and University Millage.

Debt Service Fund - to account for accumulated resources for the payment of General Long-Term Debt Principal and Interest. The department uses this fund for the deposit of money into the Long Range Building Program, Coal Tax Bond Fund, Water Development Bond Fund, and the Renewable Resources Bond Fund.

Capital Projects Fund - to account for resources used for purchase or construction of major capital facilities. The department uses this fund for the deposit of money into the Long Range Building Program.

Proprietary Funds

Enterprise Fund - to account for operations (a) financed and operated in a manner similar to private business enterprises, where the Legislature intends that the department finance or recover costs primarily through user charges; or (b) where the Legislature has decided that periodic determination of revenues earned, expenses incurred or net income is appropriate. Activities in this fund include the operation of the liquor distribution system in the state.

Fiduciary Funds

Trust Funds - to account for assets held by the state in a trustee capacity or as an agent for individuals, private organizations, other governments or other funds (Expendable Trust Funds and Nonexpendable Trust Funds). The department's Nonexpendable Trust Funds include Coal Severance Tax Permanent Fund;

Resource Indemnity Tax Trust; Coal Tax-Fish, Wildlife and Parks/Historical Society; Education Trust, and Common School Permanent Trust. During fiscal year 1988-89, the department used the Expendable Trust Funds for the coal permanent trust income.

2. Inventories

The Liquor Division maintains liquor inventories in the state liquor warehouse and liquor stores. Each year the department adjusts nonbudgeted expenditures for changes in the ending inventory amounts. The negative amounts for nonbudgeted expenditures and transfers out represent an increase in the inventory amount since the previous year. At June 30, 1990, the department's liquor inventory value was $10,261,048. The inventory is valued at the most recent cost plus freight. During September 1990, Liquor Division began operating bailment of liquor inventory in the state's liquor warehouse. Under the bailment system, liquor stored in the warehouse is owned by the vendors. The liquor does not become the state's property until it is shipped to state liquor stores. The state then has 30 days to pay the vendor for the shipment.

3. Annual and Sick Leave

Employees at the department accumulate both annual and sick leave. The department pays employees for 100 percent of unused annual leave, 25 percent of unused sick leave, and 100 percent of unused Fair Labor Standards Act leave credits upon termination. Accumulated unpaid liabilities for annual, sick, and compensatory time leave are not reflected in accompanying financial schedules. The department absorbs expenditures for termination pay in its annual operational costs. At June 30, 1990, the department had a liability of $1,043,542; $472,115; and $26,853 for annual, sick, and Fair Labor Standards Act leave, respectively.

4. Pension Plan

Employees are covered by the Montana Public Employees' Retirement System (PERS). The department's contribution to PERS was $932,754 in fiscal year 1988-89 and $867,965 in fiscal year 1989-90.

5. General Fund Balance

The General Fund is a statewide fund. Agencies do not have a separate General Fund since their only authority is to pay obligations from the statewide General Fund within their appropriation limits. Thus, on an agency's schedules, the General Fund beginning and ending fund balance will always be zero.

6. Cash Transfers

Since many of the accounting entities that the department makes entries in are not administered by the department, they are accounted for on a combining basis with any balance "transferred" to the combined entity at fiscal year-end. Thus, the "transfer" account generally represents transfers to the combined entity within the Statewide Budgeting and Accounting System.

7. Direct Entry to Fund Balance

The direct entries to fund balance in the General Fund, Expendable Trust Fund and Nonexpendable Trust Fund for fiscal year 1988-89 consist of a return of the fiscal years 1983-84 through 1988-89 coal tax investment earnings to the Coal Tax Permanent Trust Fund. In fiscal years 1986-87 through 1988-89, the department transferred the portion of coal severance investment earning appropriated by the legislature for deposit in the Coal Tax Permanent Fund to an Expendable Trust Fund. Forty-two opinions of the Attorney General, Number 110, determined that investment earnings deposited in the Coal Tax Permanent Trust Fund must not be transferred unless appropriated by a three-fourths vote of the legislature. The $15,652,570 of direct entries to fund balance returns the investment earnings to the Nonexpendable Trust Coal Tax Permanent Fund.

8. Reorganization

The Investigation and Enforcement Division financial activity is presented on the Schedules of Budgeted Program Expenditures and Transfers Out for fiscal year 1988-89. During fiscal year 1989-90, the department reorganized, and the division became part of the Director's Office. In addition, the Child Support program, which was part of the Investigation Enforcement

Division, was transferred to the Department of Social and Rehabilitation Services.

9. Nonexpendable Trust Fund Revenue

The Schedule of Budgeted Revenue and Transfers In for the Nonexpendable Trust Fund in fiscal year 1989-90 shows an estimated revenue of $6,448,000 and actual revenue of $0 for the revenue classification Other Financing Sources. This is due to a change in state law during the June 1989 Special Session. Prior to the change, section 17-5-704, MCA, required 15 percent of the earnings on the Coal Tax Permanent Fund be deposited into the Nonexpendable Trust Fund. During fiscal year 1989-90, section 17-5-704, MCA, did not allocate earnings to the Nonexpendable Trust Fund; therefore, the department deposited 100 percent of earnings into the state General Fund as required by House Bill 100, Laws of 1989.

10. Property Valuation - Local Assistance

The local assistance expenditure represents reimbursements to school districts and local governments due to revenue lost to each of these taxing jurisdictions from the reduction in personal property tax rates. The payments were authorized by Chapter 10, Laws of 1989, Special Session June 1989.

11. License and Permit Revenue

The department collects annual license fees from each licensee permitted to sell alcoholic beverages. Effective July 1, 1989, the department deposits these fees in the Enterprise Fund. Previously, these fees were deposited in the General Fund.

12. Federal Revenue

During fiscal year 1988-89, the department received federal revenue from the Child Support program. The child support function was transferred to the Department of Social and Rehabilitation Services effective July 1, 1989.

13. Negative Nonbudgeted Revenue and Transfers In

Each fiscal year the department adjusts nonbudgeted revenue for estimated income tax refunds owing to taxpayers. The department reduces current year nonbudgeted revenue for refunds it will pay taxpayers in the next fiscal year. The department also increases current year nonbudgeted revenue for refunds it paid taxpayers this fiscal year. The negative amounts for nonbudgeted revenue and transfers in represent an increase in tax refund payable balances since the previous fiscal year.

Agency Response

State of Montana

Stan Stephens, Governor

Department of Revenue
Denis Adams, Director

Room 455, Sam W. Mitchell Building
Helena, Montana 59620

January 30, 1991

RECEIVED
JAN 30 1991
LEGISLATIVE AUDITOR

Mr. Scott Seacat, Legislative Auditor
Office of the Legislative Auditor
State Capitol
Helena, Montana 59620

Dear Scott:

Thank you for the opportunity to respond to your recommendations contained in the Financial-Compliance Audit for the Two Fiscal Years Ended June 30, 1990. Our response is attached.

The Department's efforts to improve its performance will be enhanced by the analysis and recommendations of your staff. We at the Department of Revenue appreciate the professionalism exhibited by your staff while working on this audit.

Sincerely,

Denis Adams

Denis Adams
Director

Director - (406) 444-2460 Legal Affairs (406)444-2852 Personnel/Training (406)444-2866 Research/Info. (406)444-2981
"An Equal Opportunity Employer"

Recommendation #1

We recommend the department:

a. Perform a post-implementation review of the new liquor computer system to determine if the system is operating as intended.

b. Develop procedures to control systems development projects.

Agency Response

Concur.

The post-implementation review is well underway at this time. Corrective action is being implemented as the review reveals a solution to a problem. The review and corrective action are expected to be completed by April 30, 1991. The review will include the five analyses recommended on page 8.

The larger than usual inventory that existed in fiscal year 1990 is now substantially lower than fiscal year 1989 levels. This is due to implementation of the bailment warehousing system which was enabled by the new computer system. Use of bailment warehousing will allow a one-time transfer of $4 million to the general fund this fiscal year.

The cost of sales report for fiscal year 1990 has been corrected for each store and in total. As a result the amount of liquor receipts deposited by stores no longer exceeds the calculated sales.

Inaccuracies resulted from shipments and transfers that were processed on two dates being deleted from the system due to electrical storms that occurred while files were being restored. An un-interruptable power supply has been installed which will preclude this type of error in the future.

Inaccuracies also resulted from improper procedures for maintaining prices in the files. Proper procedures are in place now. Edit listings of pricing errors for each store for each month in fiscal year 1990 have been produced and are available to department auditors so that the time-consuming analyses that has been used until now can be replaced.

The department has a standard systems development procedure that it uses on all programming for which the department produces original code. The new liquor system did not undergo this procedure because it was a "turnkey" program that was believed to be a relatively straight forward conversion of an already coded package designed to service wholesale operations such as the liquor system. The experience with the liquor system has demonstrated that there can be no exceptions to the systems development procedure.

Recommendation #2

We recommend the department:

a. Submit operating plan amendments transferring appropriation authority to ensure appropriations are spent in compliance with state law.

b. Establish and implement a system to ensure transactions recorded on the state's accounting records are charged to the proper appropriation.

Agency Response

a. Concur.

Appropriations have been spent in accordance with state law. Past department practice was to treat nonrestrictive general fund appropriations in the same program as one pot of money. This had been an accepted practice by the Office of Budget and Program Planning (OBPP) with the purpose of reducing paperwork. Currently, OBPP is in agreement with the auditors that additional operating plans should be filed to document changes in the expenditure pattern. We have complied as recommended.

b. Concur.

These systems are and have been in place for some time. The problems noted by the auditors are not system problems but problems involving staff turnover and apparent lack of communication on our part. At the current time objectives related to appropriations are clear.

Recommendation #3

We recommend the department ensure its budget system monitors compliance with personal services limitations.

Agency Response

a. Concur.

We have a system in place that monitors compliance with appropriations restrictions. As noted in the discussion this was not a system problem but a question of interpretation of legislative language. We have subsequently submitted budget amendments to correct our error.

Recommendation #4

We recommend the department:

a. Obtain budget amendments to ensure appropriations are spent in compliance with state law.

b. Properly record expenditures for federal programs on the state's accounting records.

c. Request reimbursement for all allowable expenditures.

Agency Response

a,b,c Concur.

As noted in the audit report, these oversights have been corrected.

Recommendation #5

We recommend the department seek legislation clarifying state laws pertaining to personal property taxes on interstate motor vehicle fleets.

Agency Response

Concur.

With the session already in progress, it will be extremely difficult for the department to find a sponsor. We would appreciate assistance from the Legislative Audit Committee in sponsoring a committee bill clarifying this and other recommended legislation.

Recommendation #6

We recommend inheritance tax and centralized services personnel work together to accurately report inheritance tax accounts receivable on the state's accounting system.

Agency Response

Concur.

There are numerous duties and responsibilities within the department that are not performed as effectively as they could be. This is due largely to the slow but gradual erosion of staff resources. Typically, when staff are reduced, workloads do not decrease. This leads to the re-prioritization of agency workloads. Some tasks must necessarily suffer as a result. In the overall scheme of things, inheritance tax

accounts receivables is clearly a lower priority than income tax, withholding tax, corporation tax, motor fuels tax and many others. These are the areas where we appropriately concentrate our available resources. While we concur with the finding and recommendation, and will attempt to comply, we must continue to direct our resources to areas which really count.

Recommendation #7

We recommend the department update accounts receivable for tax liability settlements.

Agency Response

Concur.

See the response to recommendation # 6. We will do what we can to assure correct receivables within the limits of existing resources and other priorities in the department.

Recommendation #8

We recommend the department seek legislation clarifying state law regarding the distribution of beer and wine taxes based upon census figures.

Agency Response

Concur.

See the response to recommendation # 5.

Recommendation #9

We recommend the department seek legislation clarifying state law requiring common carriers to report to the department all shipments of cigarettes and beer within the state

Agency Response

Concur.

See the response to recommendation # 5.

Recommendation #10

We recommend the department establish procedures to ensure revenue distributions are made in compliance with state law.

Agency Response

Concur.

We have corrected the deficiencies noted in the area of proper distribution of Liquor Enterprise funds. With respect to the recording and distribution of permanent coal and resource indemnity investment earnings, we have established procedures to contact the Board of Investments prior to closing the fiscal year end books to insure, at minimum, that an estimate of earnings is properly recorded.

Recommendation #11

We recommend the department comply with state law and claim indirect costs to the maximum extent possible.

Agency Response

Concur.

Recommendation #12

We recommend the department require railroad carriers use the report form prescribed by the department.

Agency Response

Concur.

The taxpayer(s) noted in the discussion has agreed to use the department form for reporting purposes.